

Changes in the language of the current regulation to conform, to the Multistate Tax Commission's Model Regulation are shown in strike-out and underscore.

Changes proposed by staff from the Multistate Tax Commission's Model Regulation are shown in bold, strike-out and underscore

§ 25136. Sales Factor. Sales Other than Sales of Tangible Personal Property in this State.

- (a) In General. Section 25136 provides for the inclusion in the numerator of the sales factor of gross receipts from transactions other than sales of tangible personal property (including transactions with the United States Government); under this section, gross receipts are attributed to this state if the income-producing activity which gave rise to the receipts is performed wholly within this state. Also, gross receipts are attributed to this state if, with respect to a particular item of income, the income-producing activity is performed within and without this state but the greater proportion of the income-producing activity is performed in this state, based on costs of performance.
- (b) Income-Producing Activity: Defined. The term "income producing activity" applies to each separate item of income and means the transactions and activity ~~directly~~ engaged in by the taxpayer in the regular course of its trade or business for the ultimate purpose of ~~obtaining gains or profit~~ producing that item of income. Such activity ~~does not include~~ includes transactions and activities performed on behalf of a taxpayer, such as those conducted on its behalf by an independent contractor. Accordingly, income-producing activity includes but is not limited to the following:
- (1) The rendering of personal services by employees or by an agent or independent contractor acting on behalf of the taxpayer or the utilization of tangible and intangible property by the taxpayer or by an agent or independent contractor acting on behalf of the taxpayer in performing a service.
 - (2) The sale, rental, leasing, licensing or other use of real property.
 - (3) The rental, leasing, licensing or other use of tangible personal property.
 - (4) The sale, licensing or other use of intangible personal property.

The mere holding of intangible personal property is not, of itself, an income producing activity.

(c) Costs of Performance: Defined. The term "costs of performance" means direct costs determined in a manner consistent with generally accepted accounting principles and in

accordance with accepted conditions or practices in the trade or business of the taxpayer **incurred** to perform the income-producing activity which gives rise to the particular item of income. Included in the taxpayer's costs of performance are taxpayer's payments to an agent or independent contractor for the performance of personal services and utilization of tangible and intangible property which give rise to the particular item of income.

EXAMPLE:

The taxpayer contracts with a customer to perform a service for \$1,000,000 in this State and State A. The taxpayer's own costs of performance for this service are \$500,000 for both this State and State A. For this State, the taxpayer also hires a subcontractor to perform the service at a cost of \$100,000 in this State. Both the taxpayer's own costs of performance of \$500,000 in both this State and State A and the \$100,000 paid by the taxpayer to the subcontractor of the taxpayer will be taken into account in assigning the costs of performance to a state and ultimately the \$1,000,000 receipt to the sales factor numerator of a state.

(d) Application.

(1) In General. Receipts (other than from sales of tangible personal property) in respect to a particular income-producing activity are in this state if:

(A) the income-producing activity is performed wholly within this state; or

(B) the income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance.

(2) Special Rules. The following are special rules for determining when receipts from the income-producing activities described below are in this state:

(A) Gross receipts from the sale, lease, rental or licensing of real property are in this state if the real property is located in this state.

(B) Gross receipts from the rental, lease or licensing of tangible personal property are in this state if the property is located in this state. The rental, lease, licensing or other use of tangible personal property in this state is a separate income-producing activity from the rental, lease, licensing or other use of the same property while located in another state; consequently, if property is within and without this state during the rental, lease or licensing period, gross receipts attributable to this state

shall be measured by the ratio which the time the property was physically present or was used in this state bears to the total time or use of the property everywhere during such period.

EXAMPLE:

Taxpayer is the owner of 10 railroad cars. During the year, the total of the days each railroad car was present in this state was 50 days. The receipts attributable to the use of each of the railroad cars in this state are a separate item of income and shall be determined as follows:

$$\frac{(10 \times 50)}{3650} \times \text{Total Receipts} = \text{Receipts Attributable to this State}$$

(C) Gross receipts for the performance of personal services are attributable to this state to the extent such services are performed in this state. If services relating to a single item of income are performed partly within and partly without this state, the gross receipts for the performance of such services shall be attributable to this state only if a greater portion of the services were performed in this state, based on costs of performance. Usually where services are performed partly within and partly without this state, the services performed in each state will constitute a separate income-producing activity; in such cases, the gross receipts for from the performance of services attributable to this state shall be measured by the ratio which the time spent in performing such services in this state bears to the total time spent in performing such services everywhere. Time spent in performing services includes the amount of time expended in the performance of a contract or other obligation which gives rise to such gross receipts. Personal services not directly connected with the performance of the contract or other obligation, as for example, time expended in negotiating the contract, is excluded from the computations.

EXAMPLE (i):

Taxpayer, a road show, gave theatrical performances at various locations in State X and in this state during the tax period. All gross receipts from performances given in this state are attributed to this state.

EXAMPLE (ii):

The taxpayer, a public opinion survey corporation, conducted a poll by its employees in State X and in this state for a sum of \$9,000. The project required 600 person hours to obtain the basic data and prepare the survey report. Two hundred of the 600 person hours were expended in this state. The receipts attributable to this state are \$3,000.

$$\frac{(200 \text{ man } \textit{person hours} \times \$9,000)}{600 \text{ man } \textit{person hours}}$$

(3) Services on Behalf of Taxpayer. An income-producing activity performed on behalf of a taxpayer by an agent or independent contractor is attributed to a state if such income-producing activity is in such state ***as determined under this regulation, including subsection (d)(2).***

~~(a) Such income producing activity is in this state:~~

- ~~(i) — when the taxpayer can reasonably determine at the time of the filing that the income producing activity is actually performed in this state by the agent or independent contractor, but if the location of the occurs in more than one state, the location where the income producing activity is actually performed shall be deemed to be not reasonably determinable at the time of filing under (4)(C)(a)(i);~~
- ~~(ii) — if the taxpayer cannot reasonably at the time of filing where the income producing activity is actually performed, when the contract between the taxpayer and the agent or independent contractor indicates it is to be performed in this state and the portion of the taxpayer's payment to the agent or contractor associated with such performance is determinable under the contract;~~
- ~~(iii) — if it cannot be determined where the income producing activity is actually performed and the agent or independent contractor's contract with the taxpayer does not indicate where it is to be performed, when the contract between the taxpayer and the taxpayer's customer indicates it is to be performed in this state and the portion of the taxpayer's payment to the agent or independent contractor associated with such performance is determinable under the contract; or~~
- ~~(iv) — if it cannot be determined where the income producing activity is actually performed and neither contract indicates where it is to be performed, or the portion of the payment associated with such performance, when the domicile of the customer is in this~~

state. If the taxpayer's customer is not an individual, "domicile" means commercial domicile.

~~_____ (b) If the location of the income producing activity by an agent or independent contractor, or the portion of the payment associated with such performance, cannot be determined under (4)(C)(a)(i) through (4)(C)(a)(iii), or the taxpayer's customer's commercial domicile cannot be determined under (4)(C)(a)(iv), or although determinable, such income producing activity is in a state in which the taxpayer is not taxable, such income producing activity shall be disregarded.~~

(A) Such income-producing activity is in a state if the taxpayer can reasonably determine at the time of filing its return that the all of the income-producing activity is actually performed in such state by the agent or independent contractor,

EXAMPLE:

The taxpayer contracts with its customer to install satellite dishes for \$1,000,000 in this State. The taxpayer then subcontracts with and pays agent or independent contractor X to install the satellite dishes in this State for \$750,000. The taxpayer can reasonably determine at the time of filing its return that its cost of performance is in this State because that is the only location where installation services were performed. The taxpayer's cost of performance of \$750,000 paid to X will be assigned to this State pursuant to subsection (d)(3)(A) for purposes of assigning the \$1,000,000 receipt to the numerator of the sales factor.

(B) If the income-producing activity occurs in more than one state, subsection (d)(3)(A) does not apply. The income-producing activity is in a state to the extent that the contract between the taxpayer and the agent or independent contractor or the taxpayer's records indicate it is to be performed in such state and the portion of the taxpayer's payment to the agent or independent contractor associated with the performance in such state is determinable under the contract.

EXAMPLE:

The taxpayer contracts with its customer to install satellite dishes for \$1,000,000 in this State and States A and B on an as needed basis. The taxpayer then subcontracts with and pays agent or independent contractor X to install the satellite dishes in this State and States A and B for \$200 per installation. The taxpayer's records show that X installed 1,000 satellite dishes each in this State and State A and 1,750 satellite dishes in State B. The taxpayer can reasonably determine at the time of filing its return the

costs of performing installation services in each state because the taxpayer's records indicate the number of installations in each state and the taxpayer's contract with X indicate the cost of each installation. The taxpayer's cost of performance is \$200,000 in both this State and State A and is \$350,000 in State B. The taxpayer's greater cost of performance is \$350,000 in State B (\$200 x 1,750) and will be assigned to State B pursuant to subsection (d)(3)(B) for purposes of assigning the \$1,000,000 receipt to the numerator of the sales factor. (See subsection (d)(2), Special Rules, for examples of exceptions to this method of assignment of a receipt to the sales factor numerator.)

(C) If the location of the income-producing activity cannot be assigned pursuant to subsection (d)(3)(A) or (B), the income-producing activity is in a state to the extent the contract between the taxpayer and the taxpayer's customer or the taxpayer's records indicate it is to be performed in such state and the portion of the taxpayer's payment to the agent or independent contractor associated with the performance in such state is determinable under the contract.

EXAMPLE:

The taxpayer contracts with its customer to install satellite dishes for \$1,000,000 in this State and States A and B on an as needed basis. The taxpayer then subcontracts with and pays agent or independent contractor X to install the satellite dishes in this State and States A and B for \$200 per installation. The taxpayer's records show that X installed 1,000 satellite dishes each in this State and State A and 1,750 satellite dishes in State B. The contract between the taxpayer and X does not indicate the taxpayer's costs associated with X's installation of the satellite dishes in each state. However, the taxpayer's contract with its customer indicates that the cost of X's performance is \$200 per installation. The taxpayer can reasonably determine at the time of filing its return the costs of performing installation services in each state because the taxpayer's records indicate the number of installations in each state and the contract between the taxpayer and its customer indicate the cost of each installation. The taxpayer's cost of performance is \$200,000 in both this State and State A and is \$350,000 in State B. The taxpayer's greater cost of performance of \$350,000 will be assigned to State B pursuant to subsection (d)(3)(C) for purposes of assigning the \$1,000,000 receipt to the numerator of the sales factor. (See subsection (d)(2), Special Rules, for examples of exceptions to this method of assignment of a receipt to the sales factor numerator.)

(D) If the location of the income-producing activity cannot be assigned pursuant to subsections (d)(3)(A), (B), or (C), the income-producing activity is in a state if the domicile of the taxpayer's customer is in that state. If the

taxpayer's customer is not an individual, "domicile" means commercial domicile.

EXAMPLE:

The taxpayer contracts with its customer which is domiciled in State A to install satellite dishes for \$1,000,000 in this state and States A and B. The taxpayer subcontracts with and pays X to install the satellite dishes in this State and States A and B for \$750,000. The contract between the taxpayer and X and the contract between the taxpayer and its customer do not indicate the taxpayer's costs associated with X's installation of the satellite dishes in each state. The \$750,000 cost of X's performance of its contractual duties will be assigned to State A pursuant to subsection (d)(3)(D) for purposes of assigning the \$1,000,000 receipt to the sales factor numerator. (See subsection (d)(2), Special Rules, for examples of exceptions to this method of assignment of a receipt to the sales factor numerator.)

(E) If the location of the income-producing activity cannot be assigned pursuant to subsections (d)(3)(A), (B), or (C), or the customer's domicile cannot be determined, or such income-producing activity is in a state in which the taxpayer is not taxable, such income-producing activity shall be disregarded in determining the taxpayer's income-producing activity.

EXAMPLE:

The taxpayer contracts with its customer to install satellite dishes in this State and States A and B for \$1,000,000. The taxpayer contracts with X to install the satellite dishes in this State and States A and B for \$750,000. The contract between the taxpayer and X and the contract between the taxpayer and its customer do not indicate the taxpayer's costs associated with X's installation of the satellite dishes in each state. The customer's domicile is not determinable. The \$750,000 cost of performance paid to X will not be taken into account pursuant to subsection (d)(3)(E) for purposes of assigning the \$1,000,000 to the numerator of the sales factor.

NOTE: Authority Cited: Section 19503, Revenue and Taxation Code
Reference Cited: Section 25136, Revenue and Taxation Code